WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

April 8, 2013

Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington DC 20552

Re: Docket No. CFPB-2013-0004-0001, Request for Information Regarding an Initiative to Promote Student Loan Affordability

Dear Ms. Jackson,

I am writing from Woodstock Institute in response to the Consumer Financial Protection Bureau's (CFPB) request for information regarding student loan affordability which was posted in the *Federal Register* on February 27, 2013 at 78 FR 13327-13329. In addition to our own comments, Woodstock Institute supports those submitted separately by Americans for Financial Reform and the National Consumer Law Center.

Woodstock has examined the causes and effects of the housing crisis and recovery efforts over the last six years, and has decades of experience advocating for access to sustainable credit in low-wealth communities and communities of color. Our comments focus specifically on lessons learned from structures designed to promote mortgage affordability that could be adapted for use in the private student loan market. The solutions for mortgage borrowers in default or at risk of defaulting could be informative to struggling student loan borrowers, despite the differences between mortgage loans and student loans.

We encourage the Bureau to think about how programs based on affordability initiatives like the Home Affordable Modification Program (HAMP), the Hardest Hit Fund (HHF), and the Attorney General national robosigning settlement could assist student loan borrowers that find themselves in need of ways to avoid default. Our comments include four specific principles that should be included in any loan modification program, including: sustainability and affordability; effective oversight, transparency, and accountability; scalability; and strong servicing standards. Although we did not focus our comments on this, we encourage the CFPB to not only consider ways to improve loss mitigation and loan servicing, but also enact forward-looking protections to prevent a resurgence of predatory student lending practices.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. We conduct research on financial products and practices, promote effective state and federal policies, convene a coalition of community investment stakeholders working to improve access to credit, and help people use our work to understand the issues and develop and implement solutions.

Background and Context

Advocacy organizations, federal regulators, and financial experts are becoming increasingly concerned with the growing level of student debt in the United States. In 2013, outstanding student debt grew to over $1 trillion dollars, with private loans making up roughly $150 billion of that amount. There are at least 850,000 individual private loans in default, totaling roughly $150 million.[1]

From the data available specifically on private student loans, it is not fully clear which borrowers are most at risk of defaulting based on characters of the lender, loan, or the borrower. What is clear is that private student lending practices up to the Great Recession mirrored the practices of the mortgage industry with a credit boom and bust. Between 2001 and 2008, the private student loan industry grew from less than $5 billion to over $20 billion, spurred on by the demand for student loan asset backed securities.[2]

Lenders marketed loans, often directly to students, with very little underwriting and for amounts that were higher than what was needed to cover school and additional living expenses. Where previously lenders worked with schools' financial aid offices, now lenders used mass marketing techniques and distributed funds directly to consumers. This often meant that borrowers took out more money than they needed, may have been eligible for additional federal student loans but didn't know it, and were unclear of the differences between federal and private loans and repayment policies.[3] Beginning in 2008, private lenders tightened their underwriting standards, increasing the proportion of loans that required a co-signer from 55 percent of loans in 2005 to over 90 percent in 2011. The industry shrank from its peak of $20 million to roughly $6 billion by the end of 2011.

Student loans and mortgages

Student loan borrowers who took out loans during the boom years are experiencing higher rates of default today than those who took out federal loans at the same time. Over 10 percent of borrowers with loans that were originated in 2005 were in default by 2011.[4] The impact of the recession on the job market for recent graduates is likely making it hard to keep up with monthly payments and, unfortunately, there are few opportunities for payment adjustments with private loans. Increasing levels of indebtedness from student loans are tied to a decline in other types of lending, especially among younger adults.[5] It is likely that the debt loads of student loan borrowers render them ineligible for other types of loans—such as mortgages—or cause them to delay purchasing a home until they are able to pay off some of their student loans.

Significant differences between mortgage debt and student loan debt exist—student loan balances tend to be lower than mortgage balances, student loan debt is unsecured while there is a potential to build equity by paying down mortgage debt, and the business models and incentives of major actors in the transactions differ. The impact of overwhelming debt burdens can have similar impacts on a consumer's life, however, whether it is debt incurred to purchase a house or to finance an education. If a borrower goes into default, his or her credit will be tarnished and that could diminish opportunities to access employment, affordable

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[1] Consumer Financial Protection Bureau. *Private Student Loans.* (August 2012).
[2] Ibid.
[3] Ibid.
[4] Ibid.
[5] Donghoo, Lee. *Household Debt and Credit: Student Debt.* Federal Reserve Bank of New York. (February 2013).

housing, or wealth-building financial products. These additional barriers can make it even harder for the borrower to pay back his or her debt obligations.

As the CFPB looks to better understand ways to lessen the private student loan debt burden, we believe that useful lessons can be learned from efforts to reduce defaults for home mortgages in the wake of the predatory lending boom and resulting foreclosure crisis. Woodstock Institute has closely followed the performance of programs such as HAMP, HHF, and the robosigning settlement that are designed to reduce the likelihood of mortgage defaults by making monthly payments more affordable or providing assistance during a period of hardship. Woodstock Institute's comments will focus on how the successes and failures of these programs can inform the design of a potential loan modification initiative for private student loans.

Based on the experience of other loan modification programs, Woodstock Institute believes that a private student loan modification program should include the following principles:

Modified private student loans must be sustainable and affordable in the long run. It is clear that any loan modification program must adequately consider a borrower's ability to repay when determining the terms of the modified loan. In the mortgage market, it has been extensively documented that loan modifications with features that diminish affordability result in higher re-default rates.[6] Particular features that increase the likelihood of default include modifications that increase monthly payments, modifications with payments that are not tied to a borrower's income, modifications that do not pay down principal over time, and modifications that include balloon payments. Loan modifications that reduce principal balance have been shown to be extremely effective in reducing re-default on mortgage loan modifications, but this may not hold true for student loans, given the structural differences between the products.[7] More study must be done into how the characteristics of private student loan modifications affect re-default rates, since there is currently a dearth of information about effective loss mitigation strategies for this product.

Any loan modification program that includes public subsidy must have effective oversight, enforcement, and transparency mechanisms. HAMP's effectiveness suffers from the limited willingness or ability of program administrators (U.S. Department of the Treasury) to hold loan servicers accountable for complying with program requirements. After the initial launch, Treasury began to release quarterly performance audits of the servicers and temporarily withhold incentive payments for poorly performing servicers.[8] Any private student loan modification program should include strong oversight from the start of the program. Independent audits, the ability to sanction poor performance, and borrowers' ability to challenge modification decisions without waiving any rights are critical to ensuring that the program reaches the greatest number of borrowers possible and treats them fairly. The program should also be transparent enough that independent third parties could verify that the program is effective and reaching impacted groups. Data on the program performance should be released at the smallest possible geography and should include important information that could help identify fair lending concerns, including borrower characteristics such as race, ethnicity, gender, and age; information on loan terms and delivery mechanisms, such as whether the loan was marketed directly to the student versus through the school; and characteristics of the schools (such as for-profit versus non-profit, certification status, graduation rate, and so on). The Department of Education's National Postsecondary Student Aid

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[6] See Office of the Comptroller of the Currency. *OCC Mortgage Metrics Report: Third Quarter 2012.* (December 2012).; Haughwout, Andrew and Ebiere Okah, Joseph Tracy. *Second Chances: Subprime Mortgage Modification and Re-Default.* Federal Reserve Bank of New York, Staff Report no. 417. (December 2009, revised August 2010).
[7] Haughwout *et al.*
[8] See first servicer assessment: US Department of the Treasury. "Making Home Affordable Program Performance Report through April 2011." June 9, 2011.

Study can be instructive as to the data points that should be collected for private student loan modifications.

Any loan modification program must be able to meet the scale of the problem. Eligibility criteria and application processes must be crafted so that the broadest number of student loan borrowers in need of assistance can benefit from the program. The CFPB should consider whether automatic program enrollment based on borrower, loan, or school characteristics or an application process would maximize reach. The costs and benefits of programs that require mandatory servicer participation should be considered versus programs that incentivize servicer participation or programs that purchase private student loans and modify them. The abovementioned enforcement recommendation is critical to scalability as well. HAMP has met only a fraction of the borrowers it aimed to reach, in large part because of the inability of servicers to effectively implement the program.

The CFPB should enact servicing standards, similar to the mortgage servicing standards from the CFPB and national mortgage settlement, that ensure that servicers have adequate systems in place to administer the program effectively and communicate with borrowers. Failures in communication between borrowers and servicers severely limited HAMP's effectiveness. Many components of the servicing standards contained in the national robosigning settlement, as well as CFPB's servicing standards, addressed many of HAMP's shortfalls. These standards could inform private student loan servicing standards. In particular, relevant provisions may include: requirements for a single point of contact for borrower communications in order to minimize confusion and errors; an appeal and complaint process with timely responses from the servicers; timeliness in decisions made for loss mitigation measures; timely application of loan payments; transparency when the decision is made to deny a loan modification; early notification of resources when a borrower goes into default; a cessation of collection efforts when modification applications are reviewed; honoring of loan modification requests when the servicing rights on the loan are sold; and, adequate staffing levels to handle the volume of borrower complaints, as well as training requirements for staff.[9] All outreach materials should be made available in multiple languages as well.

Conclusion

Any initiative to promote private student loan affordability, including a loan modification program, should ensure that loan modifications are sustainable and affordable in the long term; that effective oversight, enforcement, and transparency mechanisms are in place; that the program can meet the scale of the problem; and that servicing standards are in place to ensure that servicers properly administer the program and communicate with borrowers.

At this point, it is difficult to make recommendations tailored to the particularities of the private student loan market because so little is known about it. The CFPB is in a unique position to gather and make public more information about the student loan market. Some issues that need further investigation include:

- How certain borrower, loan, and school characteristics affect likelihood of default;
- The incentive structure and business models of private student loan servicers;
- How characteristics of loss mitigation programs affect likelihood of re-default; and
- How counseling affects default and borrower decision-making.

[9] See Office of Mortgage Settlement Oversight. "Servicing Standards: Exhibit A." (April 2012); Consumer Financial Protection Bureau. "Mortgage Servicing Rules under the Truth in Lending Act (Regulation Z)". 12 CFR Part 1026. 2013; and Consumer Financial Protection Bureau. "Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (Regulation X)". 12 CFR Part 1024. 2013.

It is critical that the CFPB take expedient action to help private student loan borrowers avoid default, improve loss mitigation and servicing procedures, and prevent the recurrence of predatory private student lending practices. The CFPB should not allow further study into the structure of the private student loan market to unnecessarily delay rulemaking and enforcement actions.

Thank you for the opportunity to provide comment on the important issue of promoting private student loan affordability.

Sincerely,

Dory Rand

Dory Rand
President, Woodstock Institute
Chicago, IL